



Presentation to:

**City of El Paso
Mayor/City Council**

March 1, 2005

AUDIT ■ TAX ■ ADVISORY

Scope of Services



The City of El Paso asked us to identify and review existing policies/processes in place and make recommendations for improvement for the following areas:

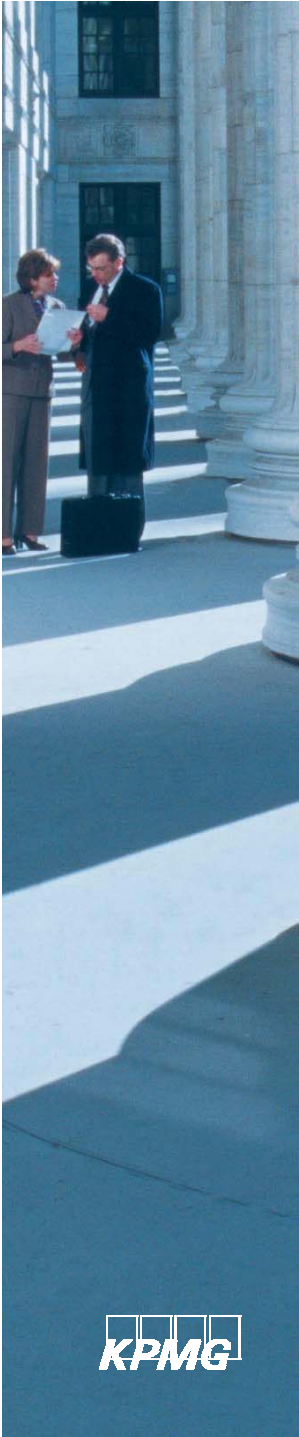
- Establishment of internal audit function – p.5-10
- Sustainability – p.11-12
- Financial policies – p.13-23
- Debt management policy – p.20-23
- Appropriate level of unreserved fund balance – p.24-27
- Budget practices/policies – p.28-33
- Use of financial status in the budget process – p.33
- Revenue policy/cash receipts controls – p.34-37
- Procurement of banking services – p.38-40
- Electronic transactions – p.41-44
- Purchasing card program – p.45-50
- Revenue policy/accounts receivable controls – p.51-55

Approach



Our approach to fulfilling the scope of services was as follows:

- Identify all written documentation regarding existing policies and processes at the City
- Meet with key City personnel to better understand what policies and/or processes exist at the City
- Identify specific recommendations for improvement based on recommended practices from sources such as
 - Government Finance Officers Association
 - Institute of Internal Auditors
 - Other applicable sources
- Report to City Council and City Management
 - Key observations found regarding existing policies/processes
 - Recommendations for improvement



City of El Paso Resources



City personnel interviewed:

- Joyce Wilson – City Manager
- William Studer – Deputy City Manager Financial and Administrative Services
- David Almonte – Director Office of Management and Budget
- Carmen Arrieta-Candelaria – Comptroller
- Byron Johnson – Director Purchasing Department
- Blanca Lorkowski – Treasury Services Manager
- Juanita Gardea – Accountant III
- Raquel Alarcon – Accounts Receivable
- Yvonne Herrera – Auditor
- Norma Prieto – Auditor

Available documentation:

- City Charter
- Organization Chart
- FY 2005 Budget Book
- FY 2005 Budget Preparation Manual
- Investment policy
- Draft financial policies
- State statute chapter 105
- Comptroller's department policies and procedures manual



Establishment of Internal Audit Function

Observations

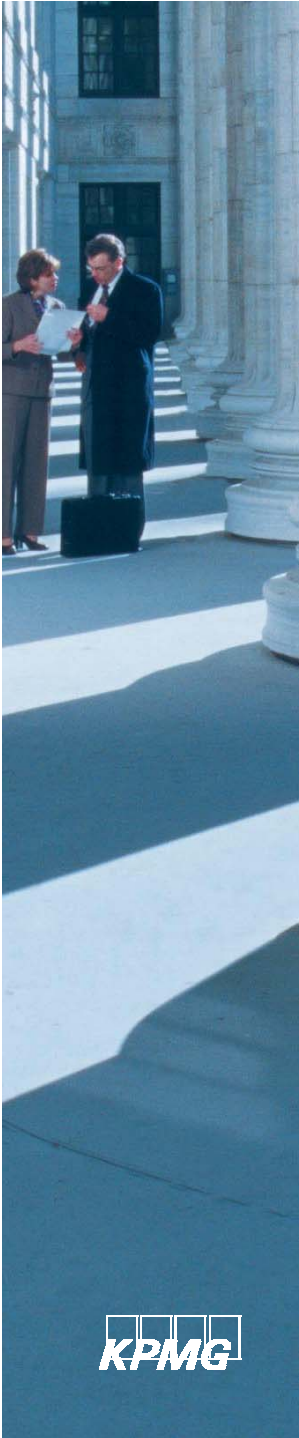


- City Internal Auditor (CIA) position is vacant and has been for the past 10 months (presently under recruitment by City Manager)
 - Comptroller is providing oversight to internal auditors until CIA position filled
- Currently, the internal audit department is comprised of only two staff auditors
 - Neither have certified internal auditor certification (not required per job description)
- No internal audit charter or other enabling resolution that governs the function of the department exists
- No internal audit plan identifying audits to be performed is prepared
- No formal policies or procedures exist to govern the conducting of an audit
- There is no audit committee and internal audit does not report routinely to the City Council
- Auditors are currently lacking basic resources
 - File cabinets – secure audit documentation
 - Private meeting space – confidential discussions
 - Clerical support – none

Recommendations



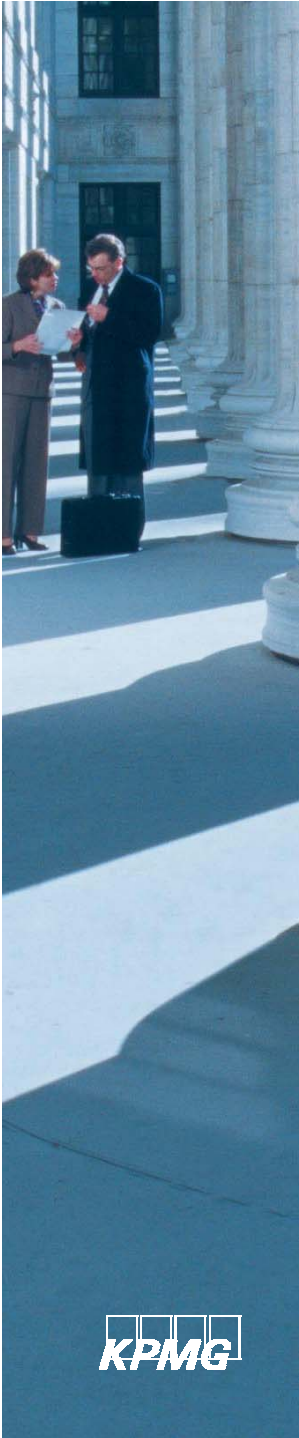
- An internal audit charter/enabling resolution should be created and formally adopted by the Council. The charter should
 - Establish internal audit's position within the organization
 - Authorize department access to records and personnel
 - Define the scope of internal audit activities
 - Identify structure of internal audit department and CIA's responsibilities
- Establish Audit Committee
 - CIA should regularly attend Mayor/City Council meetings
 - Meet with Mayor/City Council without management at least annually
- Have CIA report directly to the City Manager with "dotted line" reporting to the Mayor/City Council and/or Audit Committee
- CIA should establish formal policies and procedures to guide the internal audit activity
- CIA should establish risk-based audit plan annually – approved by the Mayor/City Council and/or Audit Committee
 - Establish priority of audits
 - Financial impact
 - Management competence
 - Quality of internal controls
 - Time of last audit
 - Complexity
- All reports as well as the audit plan should be presented to the Mayor/City Council and/or Audit Committee



Overview of Other City Internal Audit Departments



	City of El Paso	City of Albuquerque	City of Arlington TX	City of Austin	City of San Antonio
Charter or other enabling legislation	No	Yes, Accountability in Government Ordinance	Yes, administrative regulation	Yes, included in City Charter	Yes, included in City Charter
Annual audit plan prepared	No	Yes	Yes	Yes	Yes
Formal policies and procedures	No	Yes	Yes	Yes	In process
Reporting lines	City Manager	City Council and Accountability in Government Oversight committee	City Manager	Audit committee – Mayor and City Council	Governance committee – City Council
Structure	2 people No CIA	12 people CIA Audit Manager Audit Supervisor Budget auditor/IS auditor Senior auditor Principal auditor	5 people CIA Assistant CIA Senior auditors	21 people CIA Deputy CIA Assistant CIA Auditor	26 people CIA Associate Assistant



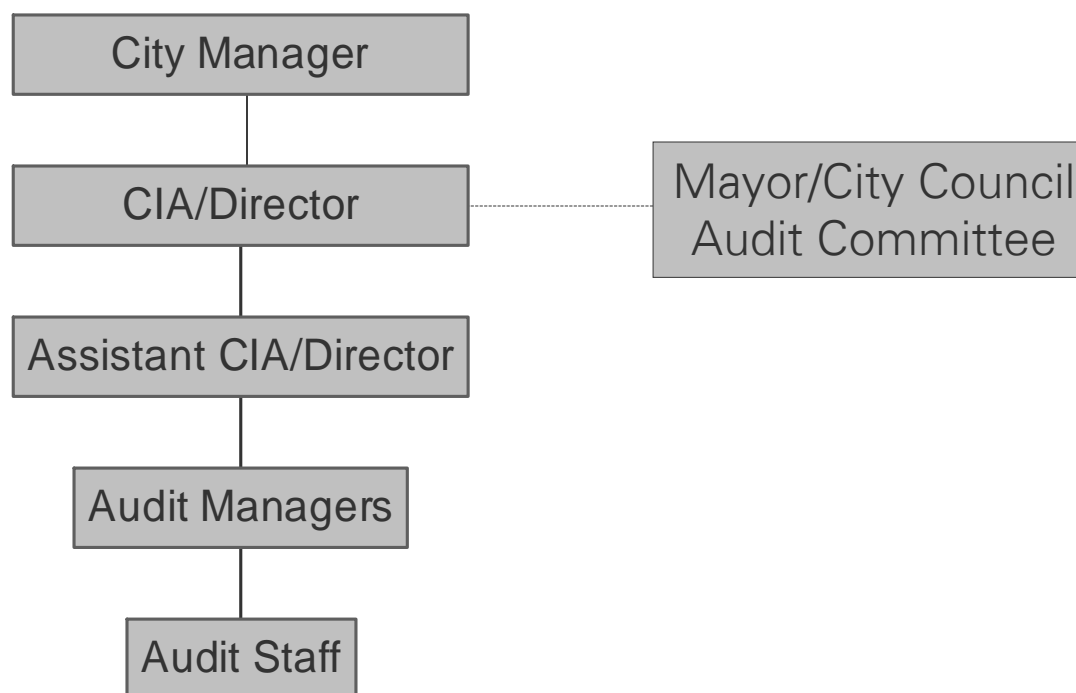
NALGA's Benchmarking Survey for FY 2004



- National Association of Local Government Auditors' Association prepares an annual benchmarking and best practices survey
- Majority of respondents are from various types of governments

	Charter/Enabling Legislation	Policies and Procedures Manual	Audit Committee
Departments with 1-3 auditors	73% - Yes	65% - Yes	50% - Yes
Departments with 4-12 auditors	95% - Yes	92% - Yes	63% - Yes

Common Structure for Internal Audit Department





Sustainability

Sustainability is the notion that current economic and consumption patterns should not reduce opportunities for future generations by depleting or impairing resources.



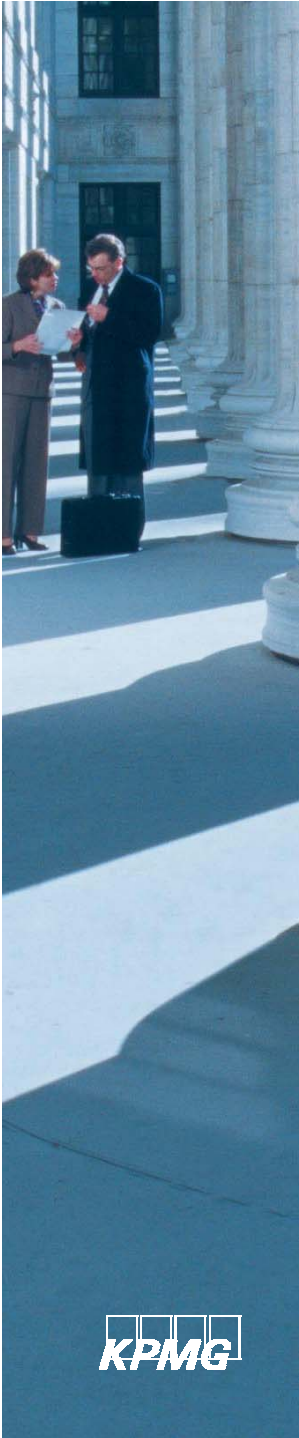
Observations/Recommendations

Observations

- No specific policies that address sustainability goals/measures
- Financial sustainability is key focus of City
 - Ensuring available financial resources for future use

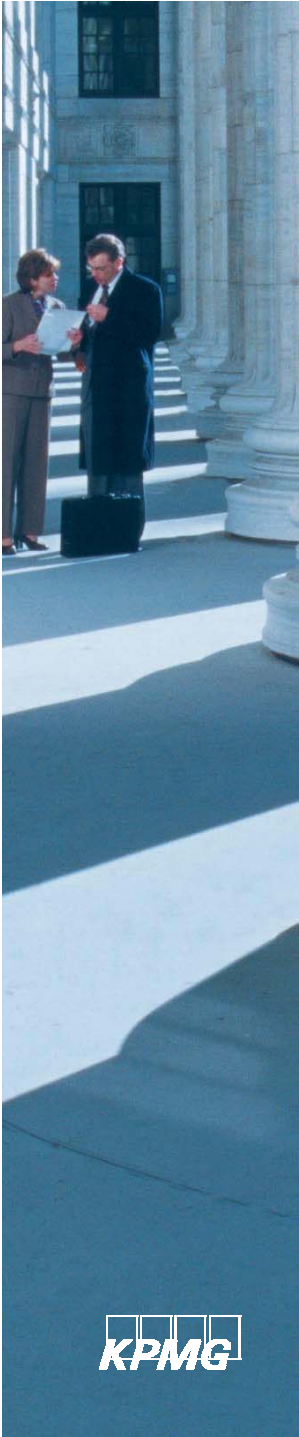
Recommendations

- Need to identify City's core mission/services
- Prepare forecasts to address City's future needs
 - Revenue projections
 - Debt service needs
 - Capital projects
 - Population
 - Legislation
- Develop the following financial policies
 - Revenue management
 - Fund balance reserve requirements
 - Debt management
 - Balanced budget
 - Current revenues = current expenditures
- Establishment of tax rates
 - Sufficient to cover cash requirements



Financial Policies





Advantages of Formal Policies



- Promote stability and continuity
- Improve efficiency and quality control
- Bond rating agencies look favorably on organizations with formal policies
- Education tool for decision makers and new employees
- Promote long-term and strategic thinking

Observations

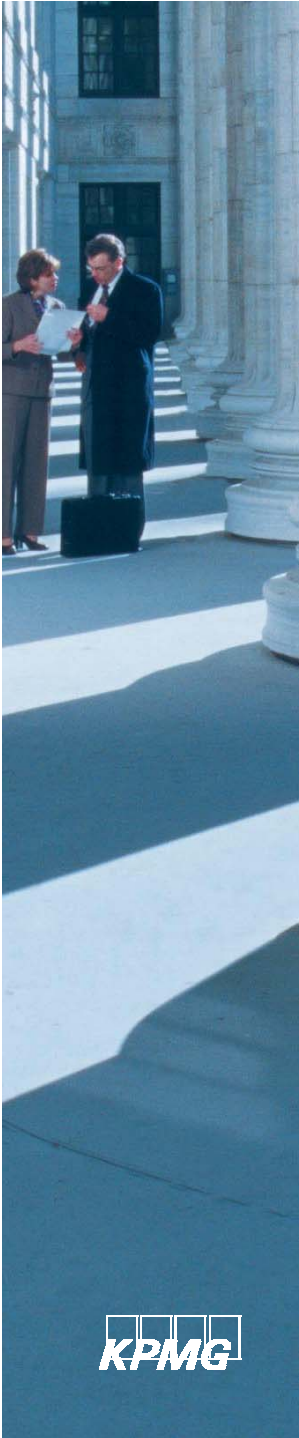


- No formal adopted financial policies exist with the exception of:
 - Investment policy
 - Budget
 - Balanced budget requirement included in City Charter
- Summary policies are included in annual budget book (not very detailed/specific)
 - Budget
 - Debt service
 - Capital improvements program
 - Revenue
 - Operating contingency
 - Cash management
- Comptroller's office has started drafting financial policies
 - Accounting, auditing and financial reporting
 - Budgeting and fiscal policy
 - Cash management
 - Debt management
 - Infrastructure policy

Recommendations



- Develop the following financial policies
 - Cash management
 - Revenue management
 - Fund balance reserves
 - Debt management
- Consider GFOA recommended policy components (see pgs. 17-23)
- Continue development of other financial policies listed on p.15
- All financial policies should be formally approved/adopted by City Council
- All policies should be reviewed periodically and updated as needed
- Internal audit should perform audits to verify compliance with each adopted policy on at least bi-annual basis



Recommended Cash Management Policy Components

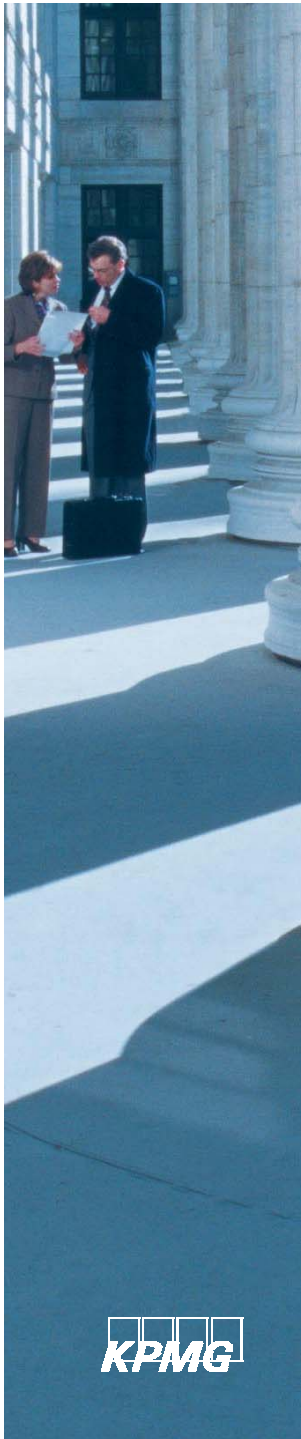


	Highly Advisable	Advisable	Optional	City of El Paso
Administration of petty cash funds	X			Included in Draft Policies
FDIC and/or collateralization requirement	X			Included in Budget Book
Investment of excess funds ▪How much ▪How often	X			
Deposit requirements for all receipts ▪Timing ▪Use of City Cashier or bank	X			
Account reconciliations	X			
Distribution of property tax collections to other agencies	X			

Recommended Revenue Management Policy Components



	Highly Advisable	Advisable	Optional	City of El Paso
Diversification and stabilization				
Prevention of fluctuations	X			
One-time revenues	X			Included in Budget Book
New revenues		X		Included in Budget Book
Estimates of revenues				
Conservative/reasonable	X			
Multi-year forecast			X	
Revenue manual			X	
User fees				
Cost recovery	X			Included in Budget Book
Review of fees	X			Included in Budget Book
Changes in fees		X		
New fees		X		



Recommended Fund Balance Policy Components



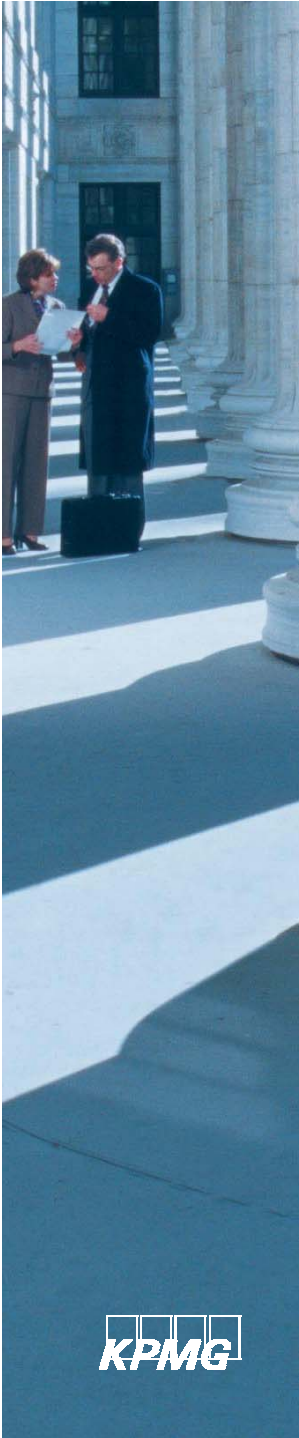
	Highly Advisable	Advisable	Optional	City of El Paso
How financial resources are set aside for unreserved fund balance (UFB)	X			
Formulas				
Deposit of operating surplus				
Dedication of specific revenues				
Determine appropriate size of UFB (select an option)	X			
No less than 5-15% of operating revenue				
No less than 1-2 months of operating expenditures				
Methods of utilizing UFB (select an option)	X			
Capital needs				
Cash flow requirements				
Emergencies				



Recommended Debt Management Policy Components



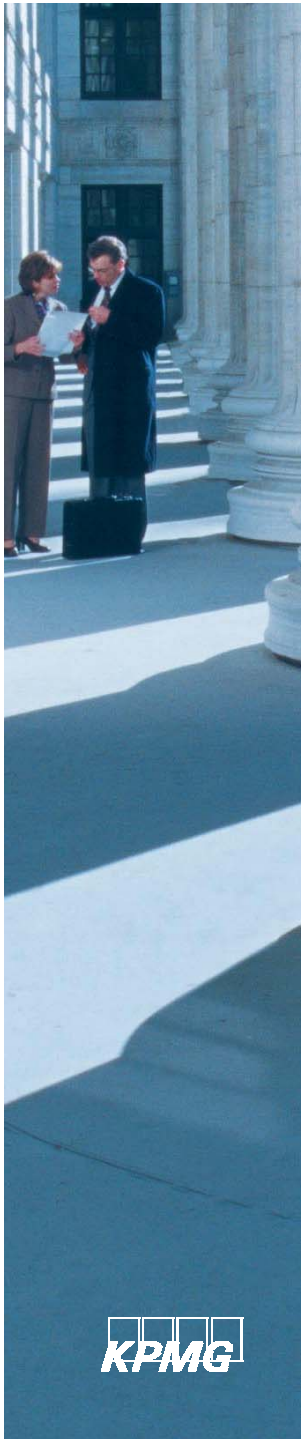
	Highly Advisable	Advisable	Optional	City of El Paso
Purpose of policy		X		
Oversight and delegation of duties		X		
Conditions for debt issuance	X			
Purpose and uses of debt	X			Included in Draft Policies
Project life	X			Included in Budget Book and Draft Policies
Types of debt	X			Included in Budget Book and Draft Policies
Refunding bonds	X			Included in Draft Policies
Restrictions on debt issuance	X			
When not to issue debt		X		
Size of issuance			X	
Limitations on maturity	X			Included in Draft Policies
Statutory limitations	X			Included in Budget Book and Draft Policies



Recommended Debt Management Policy Components, continued



	Highly Advisable	Advisable	Optional	City of El Paso
Debt service limitations	X			
General fund revenue	X			
Per capita income limitations	X			
Expenditure limitations	X			Included in Draft Policies
Limitations on outstanding debt	X			
Market value limitations	X			
Assessed value	X			Included in Draft Policies
Per capita limitations	X			
Miscellanies limitations	X			
Overlapping debt			X	



Recommended Debt Management Policy Components, continued



	Highly Advisable	Advisable	Optional	City of El Paso
Characteristics of debt structure	X			
Repayment provisions	X			
Maturity guidelines	X			Included in Draft Policies
Debt service funds	X			Included in Draft Policies
Insurance/letters of credit			X	Included in Draft Policies
Investment of bond proceeds		X		
Debt issuance process	X			
Sale process	X			
Professional services	X			
Bond rating goals			X	Included in Draft Policies
Disclosure	X			Included in Draft Policies
Rating agency relations		X		Included in Draft Policies



Recommended Debt Management Policy Components, continued



	Highly Advisable	Advisable	Optional	City of El Paso
Other forms of debt		X		
Interfund borrowing		X		
Variable rate debt		X		
Short-term debt		X		
Revenue bonds		X		
Lease debt		X		



Appropriate Level of Unreserved Fund Balance



Observations



- City currently has no existing formal adopted policy that requires a minimum requirement for UFB
 - City has past history of using fund balance to balance the budget
- City has \$16,000,000 charter reserves
 - Available for contingencies but must be replaced the following year
- City has an operating contingency policy
 - Included in annual budget book
 - Requires \$750,000 to be appropriated annually for contingencies
 - Identifies \$16,000,000 charter reserves as also available for contingencies
- Management proposed policy
 - 30-45 days operating expenditures including charter reserves

Recommendations



- GFOA recommends a formal policy be established for minimum requirements of unreserved fund balance to be maintained in the general fund
 - No less than 5-15% of regular general fund operating revenues or
 - No less than 1-2 months (i.e., 8.3-16.6%) of regular general fund operating expenditures
- In establishing policy, consider following factors:
 - Predictability of revenues
 - Volatility of expenditures
 - Availability of resources in other funds/resource needs of other funds
 - Liquidity
 - Use of designated funds



Comparison to Other Cities

	City of El Paso FY 04	City of Albuquerque FY 03	City of Arlington FY 03	City of Austin FY 03	City of San Antonio FY 03
UFB as a % of general fund operating revenues	7.7%	4.6%	13.5%	24.4%	12.5%
Including \$16MM charter reserves	14.8%	N/A	N/A	N/A	N/A
UFB as a % of general fund operating expenditures	6.9%	5.4%	13.3%	20.4%	14.3%
Including \$16MM charter reserves	13.2%	N/A	N/A	N/A	N/A



Budget Practices/Policies

Observations

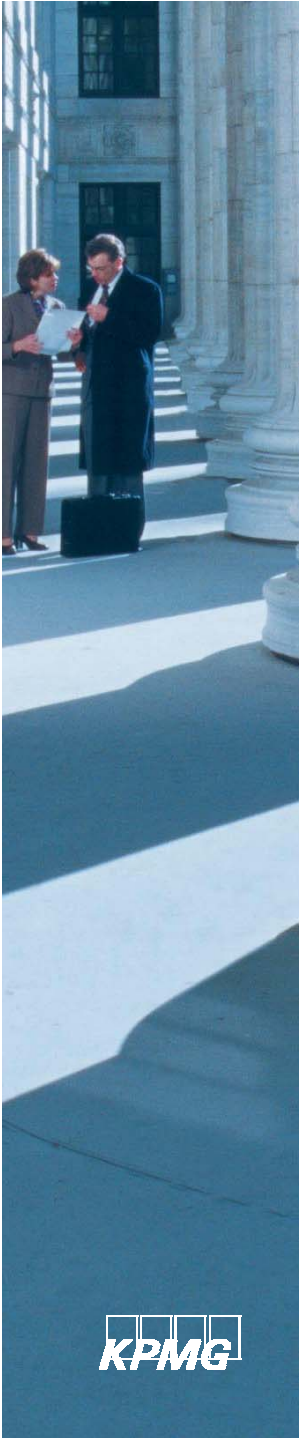


- Current budget process is formally documented but not adopted
 - Overview included in annual budget book
 - Detail included in budget preparation manual prepared annually
- Overall policy – budget must be balanced (included in Charter)
- Goal is to eliminate use of unreserved fund balance to balance the budget within next three fiscal years
- Current budget process is being reviewed by senior management
 - Departments want more involvement in establishing revenue estimates
 - City Council wants more initial input



Observations, continued

- Overview of FY05 process
 - City Manager and Mayor/City Council identify budget goals
 - Kickoff meeting is held with all department heads to communicate goals and solicit department involvement
 - Budget office together with the departments prepare projected budget
 - Projected budget sent to City Manager for review
 - City Manager sends budget to Mayor/City Council for approval
 - Budget hearings
 - Budget is adopted by Mayor/City Council
 - Budget office performs analysis (budget to actual comparisons) of general fund budget monthly
 - Budget office performs analysis of all budgeted funds quarterly
 - Any necessary adjustments are made
 - Reduction in future expenditures
 - Use of fund balance reserves



Recommended Budget Practices of the National Advisory Council on State and Local Budgeting



Principle 1: Establish broad goals to guide government decision making	Principle 2: Develop approaches to achieve goals	Principle 3: Develop a budget consistent with approaches to achieve goals	Principle 4: Evaluate performance and make adjustments
Element 1: Assess community needs, priorities, challenges and opportunities	Element 4: Adopt financial policies	Element 8: Develop a process for preparing and adopting a budget	Element 11: Monitor, measure and evaluate performance
Element 2: Identify opportunities and challenges for government services, capital assets and management	Element 5: Develop programmatic, operating and capital policies and plan	Element 9: Develop and evaluate financial options	Element 12: Make adjustments as needed
Element 3: Develop and disseminate broad goals	Element 6: Develop programs and services that are consistent with policies and plans	Element 10: Make choices necessary to adopt a budget	
	Element 7: Develop management strategies		



Comparison of Recommended Budget Practices to City's Process



Element 1: Assess community needs, priorities, challenges and opportunities	City's process includes this element.
Element 2: Identify opportunities and challenges for government services, capital assets and management	City's process includes this element.
Element 3: Develop and disseminate broad goals	City's process includes this element.
Element 4 : Adopt financial policies	City's process does not currently include this element.
Element 5: Develop programmatic, operating and capital policies and plan	City's process includes this element.
Element 6: Develop programs and services that are consistent with policies and plans	City's process includes this element.
Element 7 : Develop management strategies	City's process includes this element.
Element 8 : Develop a process for preparing and adopting a budget	City's process includes this element.
Element 9: Develop and evaluate financial options	City's process includes this element.
Element 10: Make choices necessary to adopt a budget	City's process includes this element.
Element 11: Monitor, measure and evaluate performance	City's process includes this element.
Element 12: Make adjustments as needed	City's process includes this element.

Recommendations



- As part of restructuring budget process
 - Compare existing/planned practices to recommended practices
- Adopt financial policies
 - Key recommended practice with which the City does not currently comply
- Include consideration of overall financial status of government in budget preparation process and budgetary policies
 - Available financial resources
 - Current financial status
 - Immediate financial status
 - Long-term trends
 - Revenue projections
 - Pending legislation
 - Debt service requirements



Revenue Policy: Cash Receipts Controls

Observations



- No formal adopted revenue or cash management policy exists
- Select internal controls over cash receipts tested during external audit - controls were operating effectively
 - Taxes (property, sales, other)
 - Parks
 - Zoo
 - Highways and Streets
 - Health Department
 - Municipal Court
 - Licenses and Permits
 - Sun Metro
- Treasury services is responsible for reconciling all bank account activity to general ledger
- Treasury services monitors bank account activity daily
 - Invests excess funds in accordance with investment policy
- Various departments process cash receipts but not all departments interface with general ledger so cash can't be fully reconciled every day

Recommendations



- Establish policy that addresses cash receipts
 - Revenue
 - Cash management
- Consider recommended policy components
- Formally adopt policy
- Review annually for compliance and assess if any changes are needed



Recommended Policy Components



Internal Controls Categories	Other Policy Factors
Segregation of duties	Depositing of received funds
Daily processing	Returned checks
Timely depositing of funds received	Billing practices
Reconciliation	Escrowed funds
Physical security	Budgetary review



Procurement of Banking Services



Observations



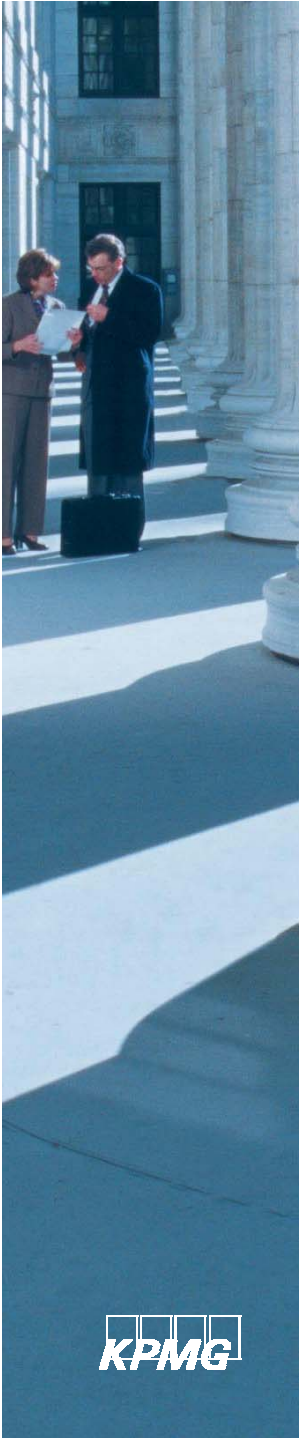
- State Statute requires provider of banking services to be selected via an application for deposit
- Banking institutions must meet certain criteria as outlined in Chapter 105 of State Statute
- Per State Statute and City Charter, City is required to enter into a new agreement every two years
 - No requirement to change providers or issue request for application
- Application requests banking institution to provide all banking services to the City
 - Payments
 - Deposits
 - Investments
 - Purchasing card system (not in effect)
 - IVR and DVR (interactive voice and internet payment systems) (not in effect)
 - Electronic funds transfer
 - Direct deposit
 - E-Pay card (not in effect)
- City just completed application process
 - 1st quarter FY 05
 - Three applications were received
- City advertised a request to complete an application
- Banks were asked to respond as to how they will meet requirements of application
- Completed applications were received
 - Comptroller's office selected a committee to review apps
 - Committee made recommendation to City Council via Council Action Form
 - City Council approved recommendation

Recommendations



- GFOA recommendations
 - Periodically initiate competitive bidding/negotiation process
 - Contracts should specify services, fees, etc.
 - Evaluate relative benefits and costs of paying for services through direct fees, compensating balances or combination
 - Evaluate cost benefit for each service

- Based on our review of the City's recent application process, the City's process included elements of the:
 - State Statute
 - City Charter
 - GFOA recommendations



Electronic Transactions



Observations



Electronic disbursements:

- Payments to employees – ACH transfers
 - Payroll
 - Pension payments
- Payments to non-employees
 - Other governmental agencies
 - ACH phone transfers
 - Wire transfers
 - Vendors
 - Limited use of wire transfers (cost prohibitive in the past)

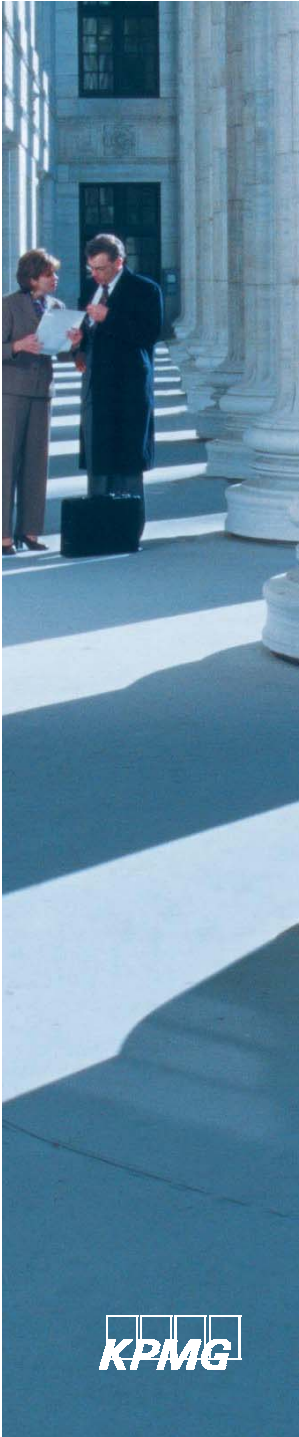
Electronic collections:

- ACH payments from governmental entities
 - Grants
- Credit card payments via internet
 - Property tax payments
 - Building permit and inspections fees

Recommendations



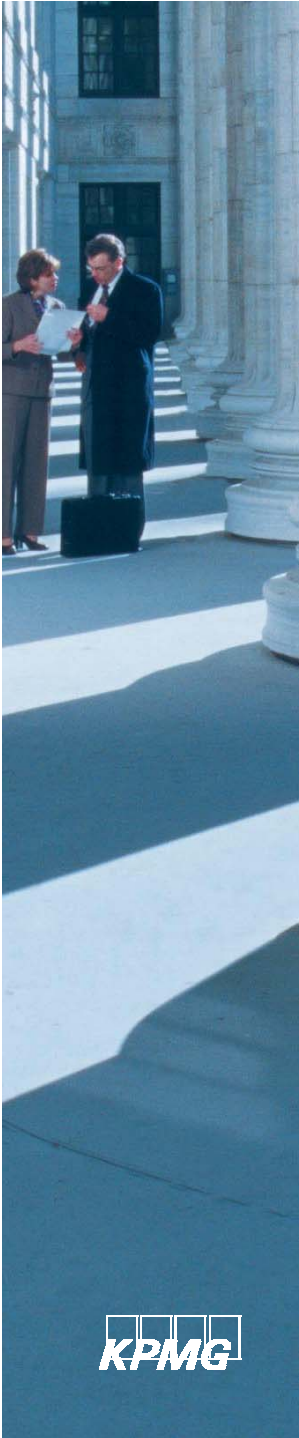
- Evaluate opportunities to increase use of
 - Direct deposit for payroll and pension payments
 - Consider using E-Pay card
 - Payments to other governmental agencies and vendors
 - Reduced fees for wire transfers
- Evaluate opportunities to increase use of electronic collections
 - Utility payments
 - License payments
 - Court fees/fines



Safeguards to Implement in Connection with Electronic Transactions



- Computer network security
 - Virus protection
 - Unauthorized use
 - Use of passwords
- Written agreements with financial institutions
- Authorization controls for both repetitive and non-repetitive transactions
- Established dollar limits
- Call-back procedures to verify transactions
- Confirmations of transactions from financial institutions



Purchasing Card Program



Observations



- The City does not yet have a purchasing card program
 - Currently gathering data (available services, vendor/user needs)
 - Goal is to roll out pilot program to a few departments later this year
- Many departments maintain petty cash funds for small purchases
 - These accounts are not always reconciled timely or recorded properly



Industry Purchasing Statistics



Average small dollar purchase	\$250
Average cost to process small dollar purchase	\$150
Small dollar purchases ▪% of total transaction volume ▪% of total purchasing volume	80% 20%

Benefits



Cardholder	Government's Internal Departments	Vendor
Convenience – no PO	Simplified purchasing process	Expedited payments
Expedited delivery of goods	Lower overall transaction processing cost per purchase	Reduced paperwork
Expanded list of merchants from whom purchases can be made	Increased management information on purchasing histories	Lowered risk of nonpayment
Reduced paperwork	Reduced paperwork	
	Controlled purchasing limits	

Recommendations



- Continue to explore implementation of purchasing card system
 - Issue competitive RFP or modify application for deposit
- Ensure proper internal controls, policy and procedures are in place prior to implementation
- Internal audit should perform audits to
 - Verify compliance with policy and procedures on an annual basis
 - Test internal controls for operating effectiveness on an annual basis



Internal Controls to Consider

- Written agreements with banks
 - Fee schedules
 - Processing procedures
- Written policies and procedures for staff
- Written acknowledgement of employee responsibility
- Spending and transaction limits for each cardholder
 - Individual transaction
 - Monthly limits
- Record-keeping requirements
 - Retention of sales receipts/purchase documentation
 - Review/approval
- Clear guidelines on appropriate use of purchasing cards
 - Approved/unapproved merchant category codes
- Clear guidelines for making purchases by telephone and fax or over the internet
- Periodic audits for card activity
- Procedures for handling disputes and unauthorized purchases
- Procedures for
 - Card issuance
 - Cancellation
 - Lost or stolen cards
 - Employee termination
- Segregation of duties for
 - Payment approvals
 - Accounting
 - Reconciliations



Revenue Policy – Accounts receivable controls

Observations



- No formal adopted revenue policy exists

Identified controls at City

- All processed invoices are reviewed by the Accounts Receivable (A/R) department
- All documentation received from the departments requesting a bill is stamped received by the A/R department
- At the end of each month, a query identifying all invoices processed by bill type is reviewed and compared to prior months to identify any significant volume fluctuations
- All system invoices are reviewed by the A/R manager prior to mailing
- A/R manager compares cash receipts logs (2) to physical checks prior to receipts being sent to Cashier
- Monthly reconciliation of customer ledgers to general ledger



Comparison of GFOA – Recommended Controls to City Controls



GFOA – Recommended Controls	City’s Controls Encompass GFOA’s Recommended Controls
Segregation of duties	Yes
Timely reconciliation of general ledger to supporting ledgers	Yes



Recommended Policy Components

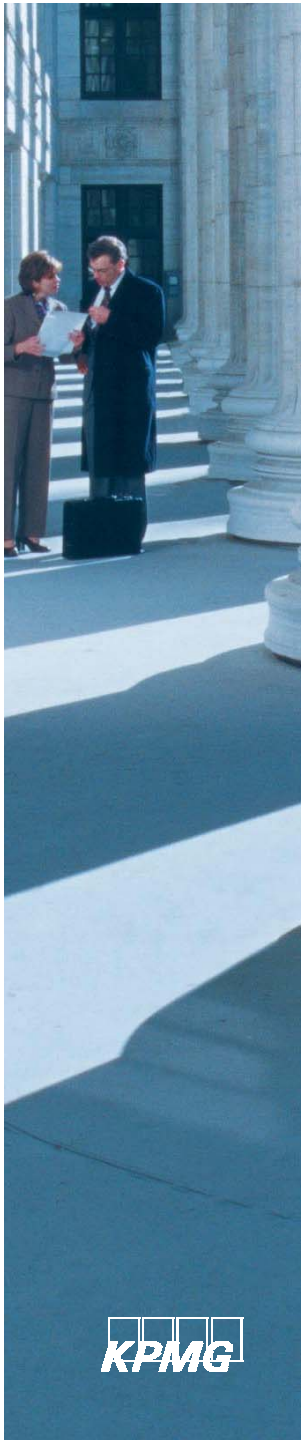


Internal Control Categories	Other Policy Factors
Segregation of duties	Depositing of received funds for services
Reconciliation	Depositing of other received funds
	Billing practices
	Collection practices

Recommendations



- Establish policy that addresses A/R
 - Revenue
 - Cash management
- Consider recommended policy components
- Formally adopt policy
- Review annually for compliance and assess if any changes are needed
- Internal audit should perform audits to
 - Verify compliance with policy and procedures
 - Test internal controls for operating effectiveness on an annual basis



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